

Internal Revenue Service

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Date: September 5, 2006

Legend

X =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

K =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Trust1 =

Trust2 =

Trust3 =

Trust4 =

Trust5 =

Dear :

This letter responds to your letter dated June 19, 2006, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

The information submitted states that X was incorporated on Date1 under the laws of State, and elected to be an S corporation on Date2. As of Date3, C, D, E, F, and G were the minor grandchildren of A and B. Prior to Date3, A and B transferred stock in X to H as custodian for each C, D, and E, and to J as custodian for each F and G. Each such custodian account was established under State Uniform Transfers to Minors Act (UTMA). On Date3, H as custodian for each C, D, and E, and J as

custodian for each F and G transferred shares of X to Trust1, Trust2, Trust3, Trust4, and Trust5 (collectively the Trusts). The Trusts, however, were ineligible shareholders and, therefore, X's election to be an S corporation was inadvertently terminated on Date3. On Date4, C, D, E, F, and G initiated corrective action so that X would once again qualify as a small business corporation. On Date5, the shares of X held by Trust1, Trust2, Trust3, Trust4, and Trust5 were transferred to their respective beneficiary.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Service.

LAW AND ANALYSIS

Section 1361(a) provides that the term "S corporation" means, for any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2) provides that certain trusts are permitted as shareholders. Section 1361(c)(2)(A) provides, in part, that § 1361(c)(2) shall not apply to any foreign trust.

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period of inadvertent termination of the S corporation election, agrees to make such adjustments (consistent with the treatment of the corporation as

an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the termination, the corporation is treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the information submitted and representations made, we conclude that X's S corporation election terminated because X had ineligible shareholders. However, we conclude that such termination was inadvertent within the meaning of § 1362(f). Consequently, we rule that X will be treated as continuing to be an S corporation from Date3, and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d). Additionally, from Date3 and thereafter, C, D, E, F, and G will be treated as the owner of the shares of X stock previously held by Trust1, Trust2, Trust3, Trust4, and Trust5. If X and its shareholders fail to treat X as described above, this ruling shall be null and void.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express no opinion on whether X is otherwise eligible to be an S corporation.

This ruling is directed only to the taxpayer requesting it. Under § 6110(k)(3), it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being mailed to your authorized representative.

Sincerely,

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel (Passthroughs
& Special Industries)

Enclosures (2)